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SUBJECT: HOPES AND FEARS: BUSINESS COMMUNITY VIEWS OF BRAZIL'S  
UPCOMING ELECTIONS AND THE NEXT GOVERNMENT

REF: RECIFE 29

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¶1. Summary: An informal survey of business leaders from Sao Paulo shows support for Finance Minister Antonio Palocci's macroeconomic policies and a general sense of relief that Lula's presidency has not destroyed the economy as originally feared. Although Lula is no longer seen as a threat to the economy, he still makes many businessmen nervous. If re-elected, they believe he is unlikely to make significant changes to the direction of the economy, as he will have to govern in alliance with such centrist and center-right parties such as the Brazilian Labor Party (PTB), the Liberal Party (PL), and the Brazilian Democratic Movement Party (PMDB). The private sector has developed an agenda of issues it would like the next government to address, including tax reform, labor reform, reduction of public expenditures, and simplification of the regulatory environment. The business community would prefer to see a candidate from the opposition Brazilian Social Democracy Party (PSDB) elected in the October presidential election, and many favor Sao Paulo state Governor Geraldo Alckmin, believing that he would be more capable than Sao Paulo Mayor Jose Serra of advancing their economic agenda. End summary.

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2006 ECONOMIC AGENDA  
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¶2. The National Confederation of Industries (CNI), a business umbrella organization which represents state Federations of Industries (of which the most influential is the Sao Paulo State Federation of Industries - FIESP), is poised to publish its economic agenda for the post-election period, a guide for whomever is elected the next President. The agenda reportedly has the concurrence of other business organizations. Its main recommendations are:

-- Cutting interest rates. While business supports the Lula administration's macroeconomic policy, including its efforts to combat inflation, it believes that a speedier pace of interest rate

reductions is possible.

-- Control of public expenditures. The Lula government has devoted more resources to social programs while withholding funds for investment. The business community would like to see these priorities reversed.

-- Greater public investment in infrastructure and implementation of public-private partnerships (PPPs). The PPP idea was introduced during the government of Fernando Henrique Cardoso (FHC) to spur infrastructure investment. Although the Lula government obtained Congressional approval of enabling legislation, currently the program exists mostly on paper.

-- A clear regulatory framework for energy, telecommunications, transportation, and natural gas.

-- A framework for environmental regulation that clearly defines the roles of responsible agencies in developing and enforcing the rules.

-- Tax reform

-- Labor law reform

-- Public investment in technology (R&D)

¶3. Of the items listed above, investment in infrastructure is considered the most urgent by many in the business community. As the economy grows, so does demand for energy, roads, railroads, and port facilities. FIESP believes the country's infrastructure is in such a critical state of obsolescence that it is adversely affecting the efficiency and global competitiveness of Brazilian companies.

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BUSINESS PERSPECTIVES  
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¶4. In 2002, Lula was generally seen by the private sector as a dangerous candidate. With his labor union background and leftist orientation, he seemed to many to pose a threat to foreign investment and private enterprise in Brazil. A turning point in his campaign was his "Letter to the Brazilians," in which he promised to

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respect international contracts and commitments and pay Brazil's debts, thus easing private sector fears.

¶5. Four years later, his performance is viewed with amazement. The business community had such low expectations for his presidency that now, though it may not approve of some of his policies, it considers his performance surprisingly good. Nonetheless, some are still nervous, noting that Lula has not been tested by an international crisis and it is impossible to know how he would react under such pressure.

¶6. Another concern among business leaders is what Lula might do if it appears he might lose the election. Would he undertake populist measures in an attempt to turn the tide? Would he be tempted to follow the example of Venezuelan President Hugo Chavez and stifle democratic opposition? Would he abandon fiscal and monetary discipline, possibly re-igniting inflationary pressures? No one is quite sure, which causes unease in the business community.

¶7. Lula has some, albeit not many, supporters among businessmen. One is CNI president Armando Monteiro Neto, a PTB federal deputy from the northeastern state of Pernambuco. Monteiro owns a sugar factory and is extremely dependent on government loans and benefits.

Similarly, CNI and other such business organizations are highly dependent on the government for funding, which comes from business taxes paid by companies. If the government were to suspend these mandatory contributions, it would force these organizations to find other sources of funds.

¶8. Other business supporters of Lula include Antoninho Marmo Trevisan (Trevisan Auditores e Consultores), Oded Grajew (founder and former CEO of Troll, a toy company), and Laurence Phi (owner of a large wheat mill), all of whom are progressive businessmen strongly tied to social causes. They believe Brazil is a country lacking in social justice and that Lula is going to change this. Another businessman, Vice-president Jose Alencar - owner of Coteminas, Brazil's largest textile firm - entered into an alliance with Lula more out of political opportunism than commitment to

Lula's social agenda. More generally, the banking sector has supported Lula and has contributed generously to the PT; recently released figures show the banks earning record profits.

¶9. Although Lula has succeeded in obtaining the support of traditional elites that generally represent the Brazilian right, on many issues his government has not promoted the core interests of these constituencies. These groups do not agree with the importance he accords to the landless movement and other social movements. They particularly deplore his administration's closeness to the Cuban, Venezuelan, and other left-leaning governments in Latin America, and a foreign policy which appears motivated more by ideology than by economic and commercial interests. The left, for its part, is frustrated with the government's failure to deliver on its promise of new ideas. Where they hoped to see more jobs and income for the poorest classes, Lula abandoned his party's platform to follow the pro-market economic policies of his predecessor.

¶10. Ultimately, while Lula is not, and never will be, a favorite of the business community, he is no longer seen as the threat to economic stability that he once was. If his poll numbers continue to improve as the electoral season progresses, he will likely attract more business interests (and contributions) to his side. The more likely it appears that he will win, the more companies will want to jump on his bandwagon, and the less onerous his fund-raising challenge will be.

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EXPECTATIONS FOR A LULA SECOND TERM  
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¶11. During the last several months of 2005, polls showed that Lula could lose the election, and many speculated he might even decide not to run. There was deep concern that, even if re-elected, he would face an extremely difficult second term. His party was

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expected to be punished for corruption with a loss of Congressional seats, and there was general disillusion with his government. More recent polls, however, show him recovering his popular support, and his government's approval ratings are returning to pre-scandal levels. In part, this is due to recent positive economic figures. The GoB is also heavily investing in advertising: the President is announcing new social programs and investments (and trumpeting the success of existing ones) almost every day, and appearing on major network television every night (reftel).

¶12. Expectations for a Lula second term, should he win one, depends how he wins the elections. There are three scenarios:

-- Lula could win but still find himself in a weak position, with no strong political allies and a small cadre of PT deputies and senators. In addition, he would face many difficulties, with little maneuvering room in Congress and a hard time getting legislation passed. He would be unable to attract high-quality people to his cabinet. In such a situation, he could turn to the social movements for support and begin to employ leftist rhetoric and populist measures. Although unlikely, this is considered the most dangerous scenario.

-- Lula could win by a large margin, with a working majority in the Congress, mainly from centrist small parties and the large PMDB. Since the PT isn't expected to do well in the congressional elections, Lula would be dependent on other parties in his electoral alliance. Still, the large margin could provide him with some political capital and an ability to set an agenda and press for some important reforms. One result would be a more centrist economic policy, without large or disruptive changes.

-- Finally, there is a middle scenario, in which Lula wins but without enough support to guarantee a comfortable majority in Congress. In this case, his second term would be very similar to his first one. Without a consistent majority, Lula would have to negotiate the vote for each piece of legislation sent to the Congress and deal with difficult deputies from his own party and allied groups. Under this scenario, a change in economic course is

unlikely, as is a reform agenda. The business community fears this eventuality, as it could lead to drift, deadlock, and stagnation. Many observers believe this is the most likely scenario.

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THE PRIVATE SECTOR AND THE OPPOSITION TO LULA  
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¶13. The majority of the private sector feels comfortable with the opposition PSDB because of its "neo-liberal" economic program. However, there is no consensus about which PSDB candidate should replace Lula. Sao Paulo governor Geraldo Alckmin is by far the favorite among companies within the state. One major supporter is Antonio Ermirio de Moraes, CEO of Votorantim Group, which owns banks, cement firms, and other enterprises. FIESP President Paulo Skaf has also expressed support for Alckmin as the PSDB's "natural candidate." During his administration, Alckmin has worked closely with the private sector and implemented some business-friendly policies, including tax cuts. Accordingly, the local business community knows and trusts him.

¶14. Sao Paulo Mayor Jose Serra, on the other hand, still carries the stigma of being considered unpredictable and strong-willed. He made enemies in the private sector while Health Minister under FHC. Serra opened the market for generic medicines, harming traditional pharmaceutical companies, and asserted Brazil's right to break patents on some HIV medications. He also fought the tobacco industry.

¶15. In the economic arena, Serra seems to be more to the left than Alckmin - even more than Lula, say his opponents. During the FHC administration, Serra was part of the so-called "developmentalist" group of advisers in opposition to the "monetarist" group of Finance Minister Pedro Malan and Central Bank President Arminio Fraga.

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Thus, he faces some opposition from the financial sector and from some parts of industry, such as pharmaceuticals. At the same time, he's considered very bright, well-educated, and determined. What remains uncertain, and therefore a source of concern, is his economic management and the direction of his policies.

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THE PRIVATE SECTOR AND THE PMDB  
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¶16. The centrist PMDB is well-connected to the private sector. Most of its members in Congress were elected with help from one or another industry. With no strong ideology, the PMDB could provide the political balance for either Lula or Serra, if one of them were to prevail in October.

¶17. The PMDB has two pre-candidates running for President - Anthony Garotinho, former Governor of Rio de Janeiro, and Germano Rigotto, Governor of Rio Grande do Sul. Garotinho is considered by many business leaders to be a dangerous, populist candidate with strong ties to evangelical churches, and a relative newcomer to the PMDB. Rigotto is more mainstream but is unknown outside his own southern state. However, if polls show Garotinho to be a viable candidate, Rigotto could become the party's alternative to the former Rio governor. The PMDB is expected to participate in the next government one way or another, either with its own candidate or via an alliance with either the PT or the PSDB. Even if the PMDB does not make an alliance to enter the next government, the party is expected to win enough seats in Congress to influence government policy through its parliamentary power. Its presence in key Cabinet posts would give the private sector confidence that radical changes in financial and economic policy are unlikely. Historically, the PMDB has kept the government in the center of the political spectrum, reassuring the economic players. That's why both the PT and the PSDB are willing to negotiate alliances for the second round with the PMDB.

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COMMENT  
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¶18. Though we are still seven months from the election, the campaign has in some respects already begun and is generating attention. What is striking, however, is how little the opposition pre-candidates have talked about policy - economic or any other - and, when they do, how little their proposals differ from each other. Everyone wants lower interest rates and more growth. Since Lula's macroeconomic policy has been a continuation of FHC's policies, the PSDB candidates haven't explained how they would change or improve it, only that they would implement it better and do a better job of fighting corruption. In the meantime, the PMDB, which hopes to offer the voters a third way, an alternative to the two main contending parties, has yet to say anything new. While there is a consensus in the business community that the next government needs to tackle long-standing and vexing problems - tax, labor, and regulatory reform - there is little confidence in the private sector that any new government (PT or PSDB) will have the political will and clout to push through the necessary legislation. End comment.

¶19. This cable was cleared/coordinated with Embassy Brasilia.

McMullen